4X Global Research

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Asian central bank policy rates – Scalpel not knife

The pace of central bank policy rate cuts has slowed sharply in the past few months (see Figure 1), in line with our view (see [Early Christmas for (still weak) global growth](), 11th December 2019).

While the emerging market central bank policy rate has fallen a further 20bp since late-October to a multi-decade low of just 4.55%, the developed economy central bank policy rate has been broadly unchanged at around 70bp according to our estimates. In particular the Fed, ECB, BoE, BoJ, RBA and RBNZ have all kept rates on hold.

The extent to which the coronavirus negatively impacts Chinese, regional and global GDP growth will going forward at least partly dictate central banks' interest rate paths, particularly in Asia-Pacific, and more broadly monetary policy.

Chinese PMI data point to only a modest slowdown in Chinese economic activity in January but they don't tell the full picture, in our view. Our core scenario at this stage is that global GDP growth, which looked set to pick-up slightly in Q1 2020 from 3.0% yoy in H2 2019, will have slowed to around 2.5% yoy in Q1, its slowest pace in a decade.

We thus think the risk is biased towards Non-Japan Asian (NJA) central banks cutting their policy rates further in coming months. The case for Bank of Indonesia is particularly compelling given slowing CPI-inflation and GDP growth and Rupiah appreciation.

However, we think the overall pace and magnitude of policy rate cuts in NJA will be modest, for two reasons.

For starters, most NJA (and EM) central banks have already cut rates aggressively in the past nine months to multi-year lows and may want to see how these rate cuts feed through to domestic growth and inflation before embarking on another round of sustained rate cuts.

Second, the Thai Baht and Korean Won Nominal Effective Exchange Rates (NEERs) have all weakened since the beginning of the year. All other things being equal this equates to a loosening of monetary policy which in turn reduces the Thai and Korean central banks' need to cut policy rates, in our view.

Pace of central bank policy rate cuts has slowed sharply since October, as expected

Back in September, we argued that "*central banks, in both developed and EM economies, have room to cut their policy rates further in coming months […]. In most economies, central banks' "real" policy rates are indeed still high relative to history and relative to global GDP growth*." (see Room and need for more central bank rate cuts, 25 September 2019). We updated our view two months ago, predicting "*central bank rate cuts to become increasingly rare over the next 12 months*" on the premise that the lagged relationship between global central bank policy rates and global GDP growth would see the latter stabilise around 3.0% yoy in H1 2020 and modestly recover in H2 2020 to around 3.5% yoy (see Early Christmas for (still weak) global growth, 11 December 2019).

So far these twin forecasts have broadly panned out. Central banks across the world, led by the Federal Reserve, continued to cut their policy rates in October-November in an arguably synchronised fashion, with a GDP-weighted measure of the global central bank policy rate falling by 15.5bp to a 21-month low of 2.17%, according to our estimates (see Figures 1 & 2).

Figure 1: Pace of central bank policy rate cuts has slowed sharply since October…

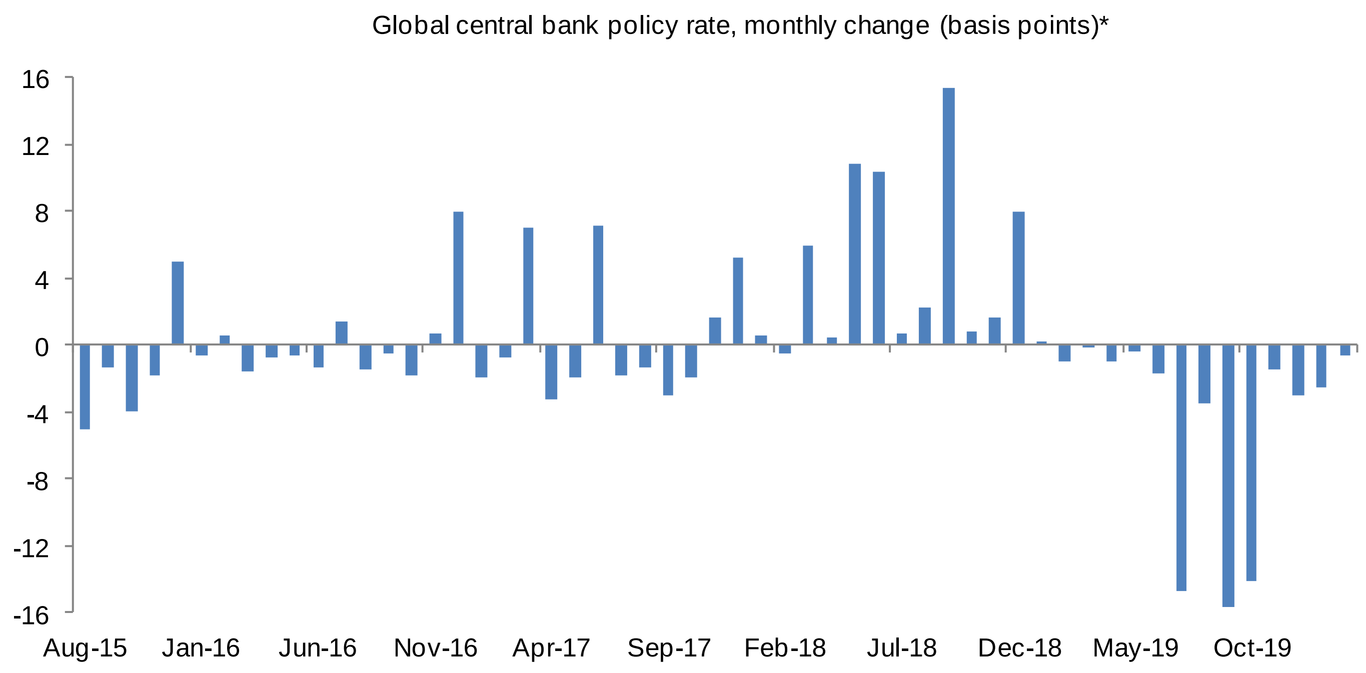


Figure: 4X Global Research, IMF, national central banks

Note: * Average using IMF Purchasing Power Parity (PPP) weighs of central bank policy rates in Australia, Canada, Denmark, Eurozone, Japan, New Zealand, Norway, Sweden, Switzerland, United Kingdom, United States, Brazil, China, Czech Republic, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Nigeria, Philippines, Poland, Romania, Russia, Singapore, South Africa, Taiwan, Thailand and Turkey.

However, since our 11th December report the global policy rate has fallen only 6bp (to 2.11%)[1], with only emerging market central banks having cut their policy rates in the past three months (see Figure 1). So while the developed economy central bank policy rate has been broadly unchanged at around 70bp since late-October, the emerging market central bank policy rate has fallen a further 20bp to a multi-decade low of just 4.55% (see Figure 2).

Figure 2: …with only emerging market central banks having since cut their policy rates

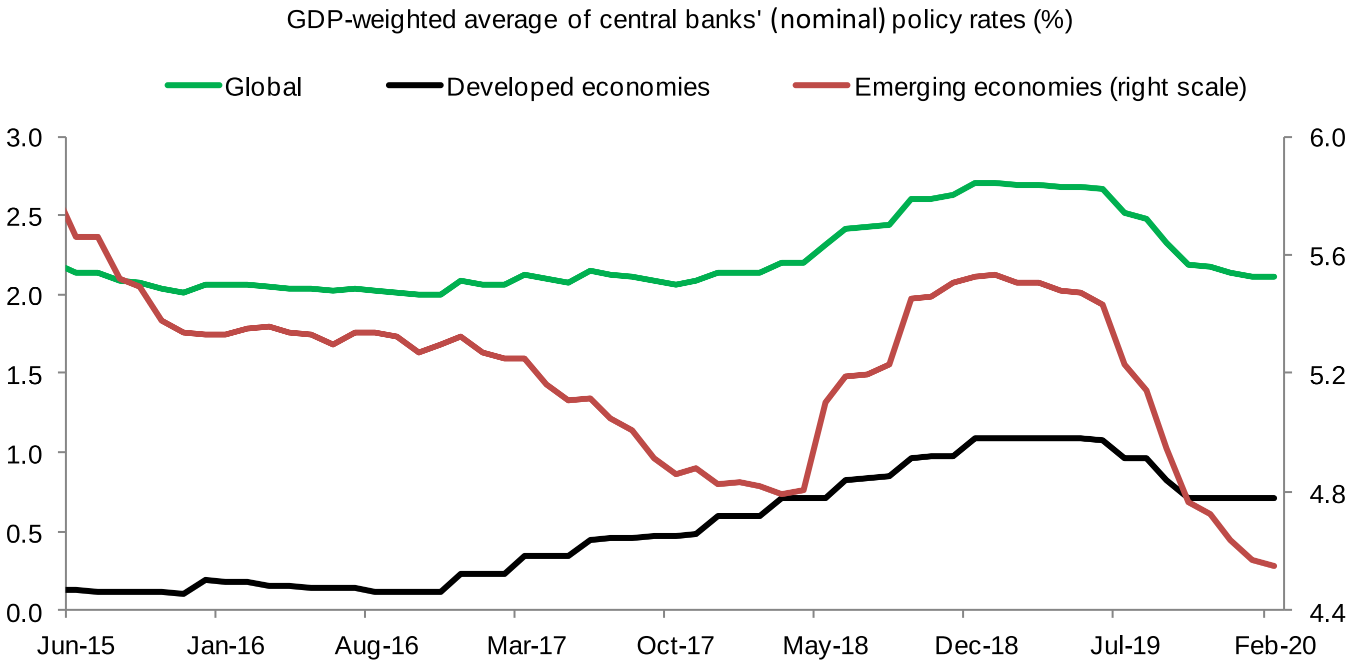


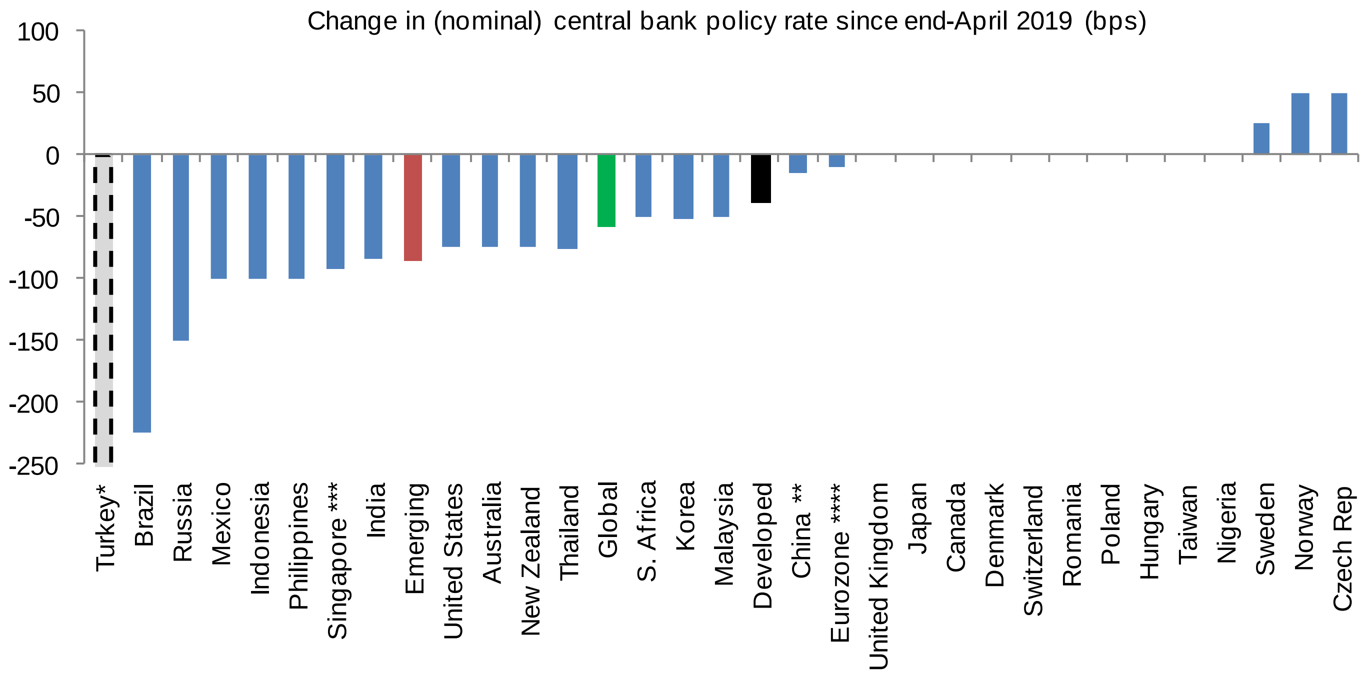
Figure: 4X Global Research, IMF, national central banks

In particular the Federal Reserve, European Central Bank (ECB), Bank of England (BoE), Bank of Japan (BoJ), Reserve Bank of Australia (RBA) and Reserve Bank of New Zealand (RBNZ) have been on hold since late-October, while the Swedish Riksbank and Czech National Bank hiked their policy rate 25bp in December and February, respectively (see Figure 3).

Moreover, the recent coronavirus outbreak in China and concerns about its impact on regional and global economic growth arguably contributed to the recent decisions by Asian central banks in the Philippines, Thailand and Malaysia and by the Brazilian central bank to cut their policy rates 25bp, in our view.

[1] No major central bank cut its policy rate in the first eleven days of December 2019.

Figure 3: Only central banks in Czech, Norway and Sweden have hiked policy rates in the past 9 months



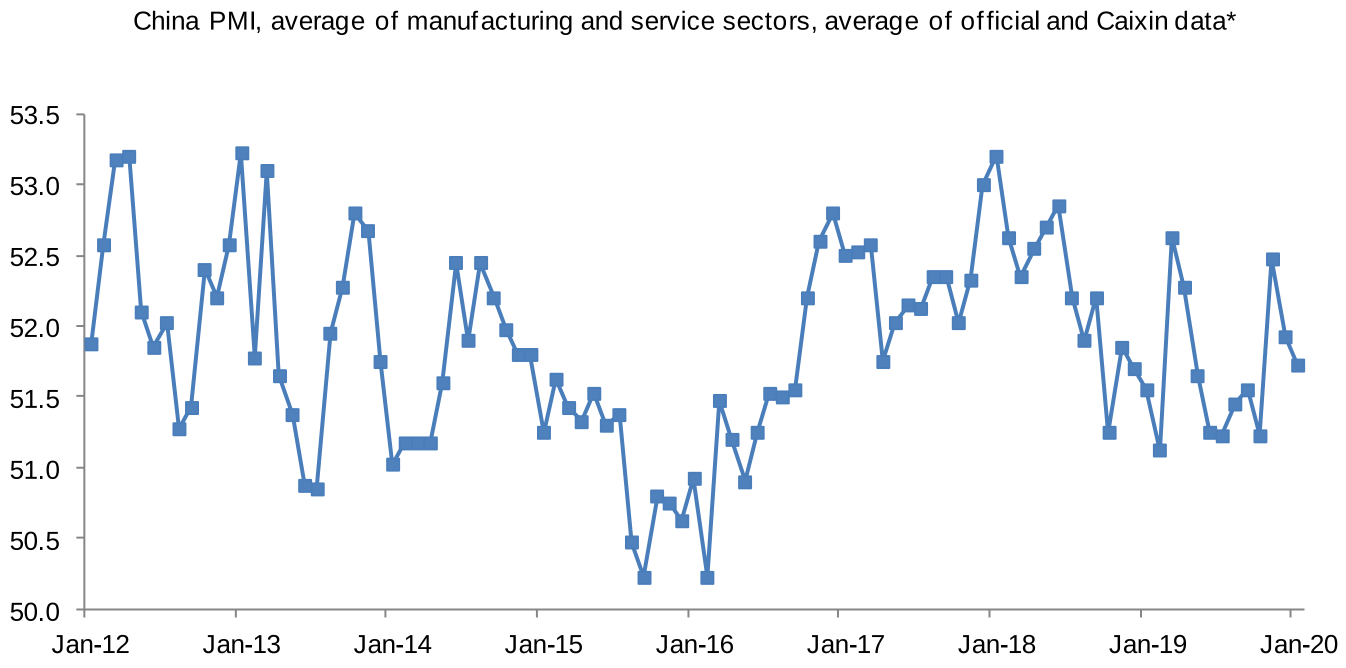
Source: 4X Global Research, IMF, National central banks

*Note: * Turkey has cut its policy rate by 1,275bp and we have truncated Y-axis. ** China: 1-year Loan Prime Rate. *** Singapore: Overnight rate average . **** Eurozone: Deposit rate*

The extent to which the coronavirus negatively impacts Chinese, regional and global GDP growth will in all likelihood at least partly dictate whether and how aggressively central banks, particularly in Asia-Pacific, cut their policy rates going forward and more broadly monetary policy. So far there has been little hard data to confirm how much Chinese GDP growth has slowed in the past month. Official Chinese PMI data (released on 31st January) and Caixin PMI data (released earlier this week) paint a somewhat mixed picture in January but overall point to only a very modest slowdown in economic activity from December within a narrow 9-month range (see Figure 4).

However, given when these PMI surveys were conducted they are unlikely to have fully captured the negative impact of the coronavirus on Chinese consumption, investment and trade. Moreover, while these official and Caixin PMI data are seasonally-adjusted, our analysis points to residual seasonality in these monthly PMI series. On average, between 2010 and 2019 the average official/Caixin manufacturing PMI rose 0.3 percentage points in the month of January (see Figure 5), while between 2012 and 2019 the official/Caixin services PMI also rose about 0.3pp in January. (see Figure 6).

Figure 4: Chinese PMI data point to only a modest slowdown in economic activity in January but…



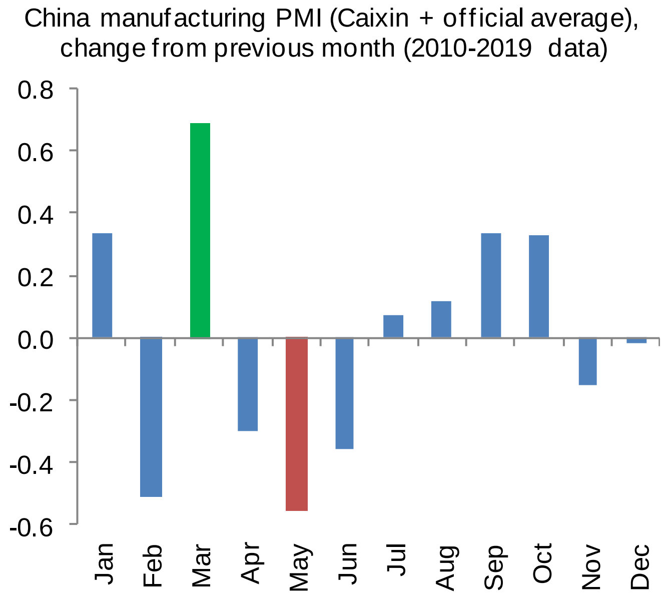
Source: 4X Global Research, Caixin, HSBC, National Bureau of Statistics

*Note: * We attribute 50-50 weights to manufacturing and services sectors and 50-50 weights to official and Caixin surveys*

Therefore the 0.35pp fall in the average manufacturing PMI in January and broadly unchanged average services PMI at second glance perhaps point to somewhat weaker economic activity than normal. In any case February PMI data are likely to provide a clearer picture of how the Chinese economy fared as the spread of the coronavirus accelerated throughout the second half of January.

Still very tentative estimates point to Chinese GDP growth, which has oscillated around 1.5-1.7% qoq in the past ten quarters, grinding to a halt in Q1 2020. This would in turn translate into year-on-year growth slowing to below 5% from 6.0% in H2 2019 and, if correct, would alone shave about 0.2 percentage points from global GDP growth in Q1 2020, according to our estimates. Of course the overall impact on global economic growth is likely to be greater on the assumption that GDP growth in other major economies will also likely be weaker than it would have been.

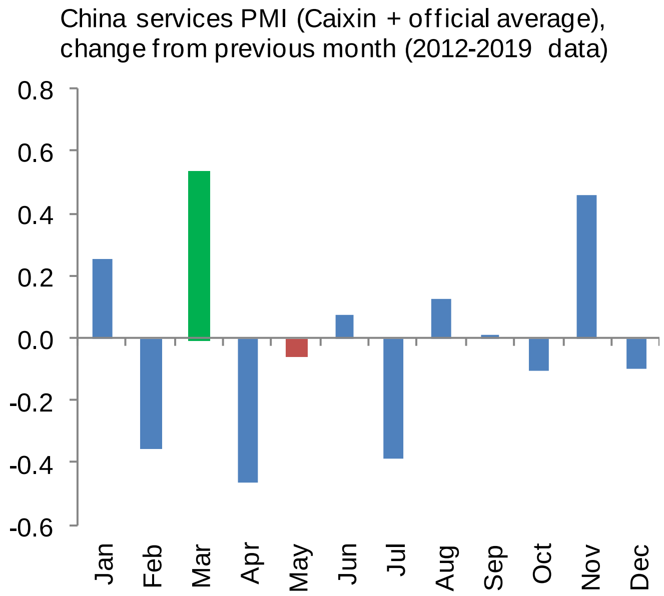
Figure 5: …historical PMI data suggest that activity normally picks up in January in manufacturing…



Source: 4X Global Research, Caixin, HSBC, National Bureau of Statistics

** We attribute 50-50 weights to official and Caixin surveys*

Figure 6: …and the Chinese services sector

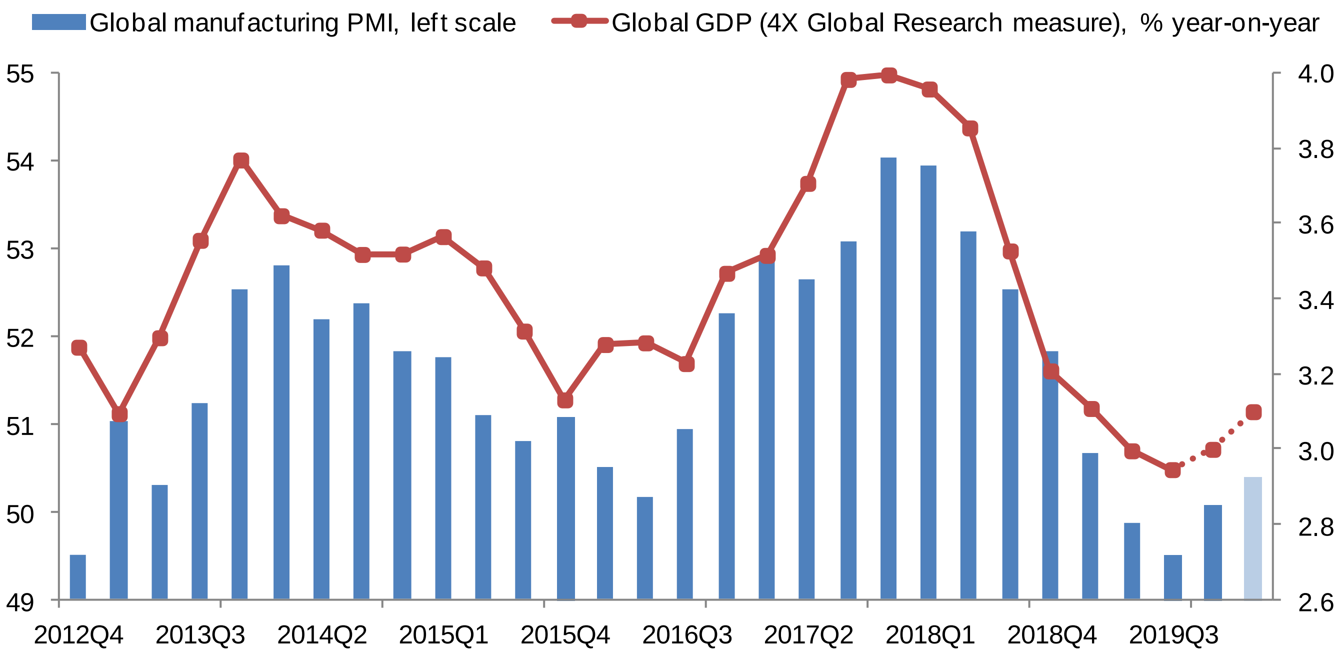


Source: 4X Global Research, Caixin, HSBC, National Bureau of Statistics

** We attribute 50-50 weights to official and Caixin surveys*

Prior to the outbreak of the coronavirus, which was officially reported five weeks ago, there was hope that global GDP growth, which had stabilised at around 3.0% yoy in H2 2019, would slowly start to recover in 2020. Indeed the up-tick in the global manufacturing PMI to 50.4 in January 2020 from 50.1 in Q4 2019 pointed to growth in Q1 having inched higher to 3.1% yoy – a still modest rate of growth by historical standards but a further step in the right direction (see Figure 7). At this very early stage we forecast that global GDP growth will slow back to around 2.5% yoy in Q1 2020, its slowest pace of growth in a decade (GDP growth in Q4 2009 was around 2.3% yoy).

Figure 7: The coronavirus is likely to have to have reversed the recent, modest recovery in global growth



Source: 4X Global Research, IMF, national statistics offices, OECD

Note: Latest PMI data point is for January 2020. Global GDP growth is 4X Global Research's quarterly measure using IMF PPP-weights. Q4 2019 is estimate based on Q4 manufacturing PMI data and actual GDP data for China, Eurozone, Indonesia and United States (which account for almost 75% of world GDP). Q1 2020 GDP is forecast.

Further Asian central bank rate cuts unlikely to be aggressive, at this stage

With this in mind we think the risk is biased towards Non-Japan Asian (NJA) central banks cutting their policy rates further in coming months. In the Philippines central bank Governor Diokno said that the BSP, which cut its policy rate 25bp yesterday, could loosen policy further to protect under-pressure domestic growth. There is also a compelling case for Bank of Indonesia to cut its policy rate, as we argue below. However we think the overall pace and magnitude of rate cuts in NJA will be modest, for two reasons.

For starters, most NJA central banks – and emerging market central banks more generally – have already cut policy rates aggressively in the past nine months to multi-year lows and may want to see how these rate cuts feed through to domestic growth and inflation before embarking on another round of sustained rate cuts (see Figure 3). Specifically since late-April 2019:

- Central banks in **Indonesia** and the **Philippines (BSP)** have each cut their policy rates 100bp, to respectively 5.0% (21-month low) and 3.75% (19-month low);
- Reserve Bank of **India** has cut its policy rate 85bp to a decade-low of just 5.15%;
- Bank of **Thailand** has cut its policy rate 75bp to a record-low 1.00%;

- Bank of **Korea** and Bank Negara **Malaysia** have each cut rates 50bp to respectively 1.25% (29-month low) and 2.75% (nine-and-a-half year low);

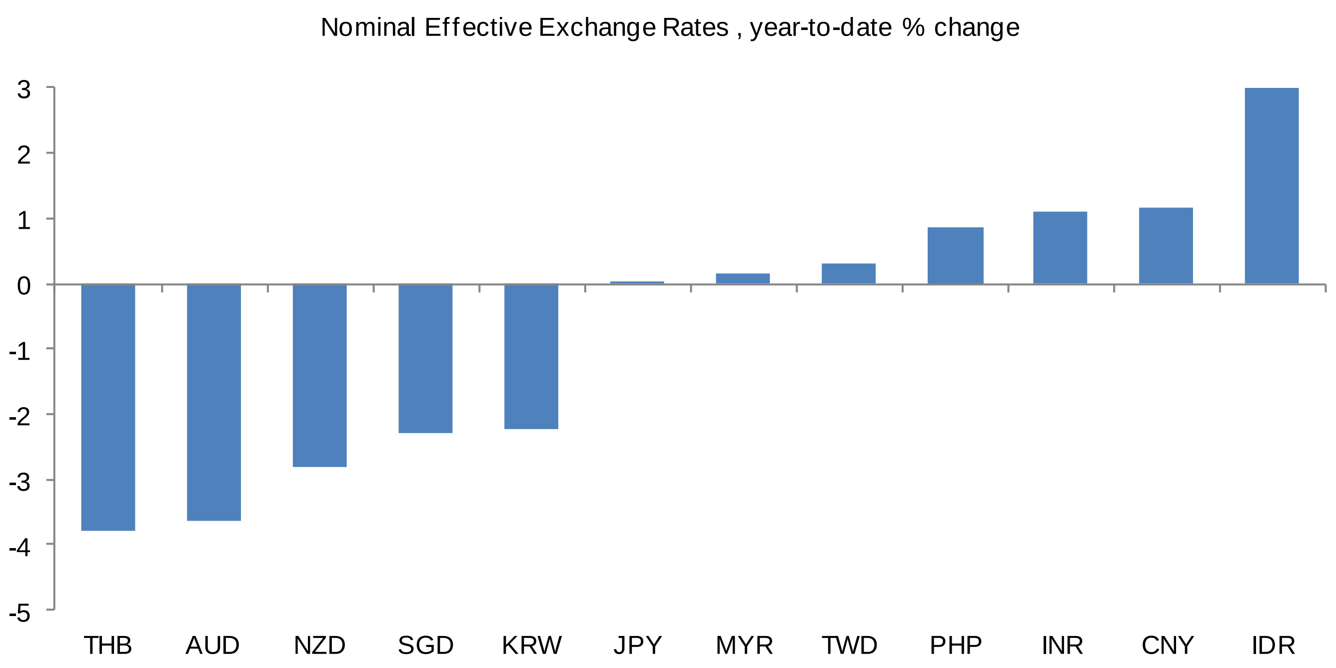
- **Singapore's** overnight rate average was trading around 0.8% on 7th February, down 90bp; and

- The People's Bank of **China** has cut its one-year Loan Prime Rate 16bp to 4.15%, cut commercial banks' Reserve Requirement Ratios by 100bp and recently stepped up liquidity injections into the markets via reverse repo operations while cutting its 7-day and 14-day reverse repo rates by 10bp.

- The Central Bank of **Taiwan** is the only major central bank within NJA which has left its policy rate unchanged during this period (at 1.375%). The last time the CBC changed rates (a 12.5bp rate cut) was back in June 2016. However, the gradual rise in Taiwan's headline CPI-inflation rate to a 20-month high of 1.9% yoy in January probably limits CBC's scope to cut its policy rate, in our view.

Second, the Thai Baht and Korean Won Nominal Effective Exchange Rates (NEERs) have all weakened since the beginning of the year (see Figure 8). All other things being equal this equates to a loosening of monetary policy which in turn reduces the Thai and Korean central banks' need to cut policy rates, in our view.

Figure 8: NJA currencies' performance YTD has not been uniform which may colour the need for rate cuts



Source: 4X Global Research, BIS, investing.com

Conversely, the Indonesia Rupiah NEER has appreciated 3.2% year-to-date to its strongest level since August 2017 (see Figure 8). Rupiah appreciation – 12% since October 2018 – has likely contributed to the sustained fall in headline CPI-inflation to 2.7% yoy in January 2020 from 3.5% yoy in August and the slowdown in GDP growth to below 5% yoy in Q4 2019 from 5.3% yoy in Q2 2018. At the same time Bank Indonesia has left its policy rate unchanged at 5.00% since October 2019, resulting in its "real" policy rate rising to a six-month high of 2.3% at end-January 2020, according to our estimates.

This tightening of Indonesian monetary policy – a higher "real" central bank policy rate and stronger rupiah – is somewhat at odds with slowing domestic economic growth and an uncertain outlook for domestic, regional and global economic growth, in our view. We conclude that the odds of Bank Indonesia cutting its policy rate in coming months are high, both in absolute terms and relative to other NJA central banks.

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